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In the Supreme Court of the United States

OCTOBER TERM, 1944

No. 1188

SUNRAY OIL COMPANY, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE TENTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The findings of fact and opinion of the Tax Court of the United States (R. 100–105) are reported at 3 T. C. 251. The opinion of the Circuit Court of Appeals (R. 227–234) is not yet reported.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on February 21, 1945 (R. 235), and a petition for rehearing (R. 239–259) was denied on March 16, 1945 (R. 261). The petition for a writ of certiorari was filed on April 21, 1945.

The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTIONS PRESENTED

1. Whether overruled decisions of this Court grant the petitioner immunity from taxation on income from lands leased from a state, with respect to the period before the date of overruling.

2. Whether the petitioner's gross income may be reduced in the amounts of allocable portions of bonuses paid to obtain leases on oil and gas lands, in addition to the amounts allowed as percentage depletion under Section 114 (b) (3) of the Revenue Acts of 1936 and 1938 and of the Internal Revenue Code.

STATUTES AND REGULATIONS INVOLVED

The pertinent statutory and regulatory provisions are set forth in the Appendix, *infra*, pp. 8–13.

STATEMENT

During 1936 and 1937, the petitioner purchased oil and gas leases upon lands owned by the State of Oklahoma for cash bonuses and promises to pay specified royalties from oil produced. In its returns the petitioner claimed that its income from these leases was exempt from federal taxation. (R. 101.) Portions of the bonuses paid for the leases obtained from the State, and certain other leases obtained from private persons,

may be allocated to the taxable years on the basis of estimated oil reserves and oil produced during the taxable years as follows (R. 102):

1936	$25,339.12
1937	54,474.06
1938	35,041.74
1939	29,622.61

The Tax Court and the court below held that the petitioner's income from the state leases was not immune from federal taxation. Both courts also held that, as the Commissioner had determined, the portions of the bonuses allocable to the products sold during the taxable years in question and excluded from the petitioner's gross income from the property for those years in computation of percentage depletion should be included in its gross income under Section 22 (a) of the Revenue Acts of 1936 and 1938. (R. 100–105, 227–234.)

ARGUMENT

1. The petitioner presents nothing warranting the issuance of a writ by its effort (Pet. 6–10) to have *Burnet* v. *Coronado Oil & Gas Co.*, 285 U. S. 393, and *Gillespie* v. *Oklahoma*, 257 U. S. 501, applied to sustain its claim to constitutional immunity from federal taxation of income during the period before those decisions were formally overruled by *Helvering* v. *Mountain Producers Corp.*, 303 U. S. 376, on March 7, 1938. As this Court pointed out in its opinion in the latter case, the earlier cases relied on by the petitioner had been undermined by intervening decisions. Their over-

ruling did not mark a sudden change in the law, but rather the culmination of a long process of development. This Court applied its overruling decision to income of a period of prior years.

Further developments in the law of immunity from federal taxation of income were announced in *Helvering* v. *Therrell,* 303 U. S. 218; *Helvering* v. *Gerhardt,* 304 U. S. 405; and *Graves* v. *N. Y. ex rel. O'Keefe,* 306 U. S. 466. A petition for rehearing was filed in the *Gerhardt* case, asking that the decision be limited to prospective application. In his memorandum in reply, Solicitor General Jackson conceded that in appropriate circumstances this Court would have power so to limit a decision of its own. He concluded, however, that the *Gerhardt* case was an inappropriate one; and this Court denied the petition for rehearing (305 U. S. 669). Shortly thereafter, Congress expressly limited to the future the application of the *Gerhardt, Therrell* and *O'Keefe* cases. Section 203 of the Public Salary Tax Act of 1939, c. 59, 53 Stat. 574, 576.

Section 3791 (b) of the Internal Revenue Code (26 U. S. C., Sec. 3791) does confer upon administrative officials discretionary power to grant relief from the retrospective effects of judicial decisions. See *Helvering* v. *Griffiths,* 318 U. S. 371, note 49, p. 398. The Bureau of Internal Revenue expressly ruled, however, that the *Mountain Producers* case was to be applied to the period before the date of the opinion as well as

to the period thereafter. Mim. 4755, 1938–1 Cum. Bull. 179.

At least at this late date, the claim of the present petitioner for judicial relief is much weaker than that advanced in the *Gerhardt* case.

2. The court below decided that the petitioner was not entitled to exclude allocable amounts of bonus payments (advance royalties) from its gross income after taking depletion on the percentage basis provided by Section 114 (b) (3).[1] This was plainly correct.[2]

The amounts of the petitioner's receipts allocable to the bonus payments were part of its gross income under Section 22 (a), since they were received as its own without any obligation to pay them over to another. Any exclusion or deduction from income on account of the consumption of the petitioner's mineral interests is wholly a matter of legislative grace (*Helvering* v. *Bankline Oil Co.*, 303 U. S. 362, 366–367), and the petitioner has the burden of pointing to a provision of the statute conferring a right thereto in plain and unmistakable terms (*New Colonial Co.* v. *Helvering*, 292 U. S. 435, 441).

[1] References to sections are to sections of the Revenue Act of 1936 and corresponding provisions of later statutes; references to articles are to articles of Regulations 94 and corresponding provisions of subsequent Regulations. These are all set forth in the Appendix, *infra*, pp. 8–13.

[2] Cf. *Quintana Petroleum Co.* v. *Commissioner*, 44 B. T. A. 624, affirmed, 143 F. (2d) 588 (C. C. A. 5th); *Canadian River Gas Co.* v. *Higgins* (S. D. N. Y.), decided March 2, 1945 (1945 C. C. H., par. 9250).

A bonus payment is not part of the "cost of goods sold" within the meaning of Article 22 (a)–5. Such a construction would be quite inconsistent with the long-settled rule that gross income includes the entire selling price of oil. *Stanton* v. *Baltic Mining Co.,* 240 U. S. 103. A bonus payment is "consideration for the lease" (*Burnet* v. *Harmel,* 287 U. S. 103, 112) which gives rise to a valuable right in the lessee to extract minerals and retain the proceeds thereof (*Douglas* v. *Commissioner,* 322 U. S. 275, 285–286), and hence constitutes a capital expenditure for purposes of the lessee (*Baton Coal Co.* v. *Commissioner,* 51 F. (2d) 469 (C. C. A. 3d), certiorari denied, 284 U. S. 674).

Had the petitioner taken depletion on the cost basis provided by Section 23 (m) and 114 (b) (1), it would have been allowed deductions in the amounts of the allocable portions of the bonus payments. It did not take depletion on this basis, however, but availed itself of the higher percentage allowance under Section 114 (b) (3). The petitioner's argument is essentially one that it is entitled to employ both methods at once and thus obtain a forbidden double deduction.

The provision of Article 23 (m)–1 (g) that allocable amounts of advance bonus payments are not included in "gross income from the property" as that term is used in Section 114 (b) (3), is required by the rule that percentage depletion is a single allowance which must be apportioned be-

tween the lessor and the lessee. Section 23 (m); *Helvering* v. *Twin Bell Syndicate,* 293 U. S. 312. Since the lessor is entitled to a percentage depletion allowance on the bonus payments (*Herring* v. *Commissioner,* 293 U. S. 322), it necessarily follows that the lessee is not. This rule, designed solely to prevent two taxpayers from securing allowances with respect to the same item of depletion, has no application to the question presented here.

CONCLUSION

The decision below is correct and there is no conflict. The petition for a writ of certiorari should therefore be denied.

Respectfully submitted.

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MAY 1945.